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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 335

UNITED STATES OF AMERICA, WHICH SUES FOR THE USE AND BENEFIT OF CHARLES P. WILHELM, TRUSTEE, ETC., ET AL.,

Petitioners,

vs.

NELLIE FLYNN CHAIN, EXECUTRIX OF THE LAST WILL AND TESTAMENT OF JAMES W. FLYNN, DECEASED.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR PETITIONERS.

F. E. PARRACK,
Counsel for Petitioners.

INDEX.

Subject Index.

	Page
Statement of Case:	
Action was debt on bond	1
Bond was executed by respondent's testator to make The Kingwood National Bank a depository of bankrupt funds	1
Bank failed owing petitioner as trustee in bankruptcy, and suit was on the bond in the District Court	2
Judgment was for petitioner against the Bank, and sureties and respondent alone appealed	2
Stipulation:	
All allegations of the declaration stipulated to be true	2
Other stipulations relied on by respondent, stipulated to be true if material	3
Judgment:	
Was for petitioner under date of September 21, 1935, for $3,680.25	3
Jurisdiction:	
Grounds relied upon for jurisdiction of this Court	4
Circuit Court of Appeals erred in reversing and setting aside	4
Specification of Errors:	
Reversing judgment	4
Holding bond not analogous to official bond	4
Holding bank did not become an actual but only a potential depository	4
Holding District Court must take notice of death of sureties	5
Holding that neglect of duty by the Court can prejudice creditors	5
Adjudging Flynn's estate was released by his death	5
Summary	5

Argument:
Bond:
Page
Is payable to the United States 6
Makes a depository an agency of the Government 6
Approval of in suit made it a binding contract, not an offer to contract to be accepted by a depositing trustee 7
If it were an offer to contract, trustee would have no authority to accept; acceptance must be by the court and approval is acceptance 7
Analogous to official bond, and not one securing series of sales 7
Consideration was the status given bank, and paid all at one time; it was not the deposits afterward made 7
Court must require on designating depository 7
Suit on, in the name of the United States is actually for the use of bankrupt creditors 7
Is similar to constable's bond, and death of surety does not end liability 8
Is not a mere revocable offer to contract ... 8
Execution and approval makes the bank an actual depository, and it does not alternately have and lose status as such as deposits are made and withdrawn 8
Distinction between private bonds and those affected with public interests 9
Opinion of the Court:
Assumption without justification from the record that no trustee except petitioner deposited money in depository in question 6
Holds bank was never an actual depository until deposits were made 6
Holds that the bond was mere offer to contract and was accepted by depositing money therein 6
Holds the bond to be like guaranty of series of sales and unlike official bond 7

Page

Shows that if consideration was given all at one time, death of surety does not discharge him, but holds that consideration of this bond was deposits made from time to time 9
Reasoning is unsound 9
Depositories:
Court must designate and fix penalty of bond 7
Bank becomes an actual and not a potential depository on execution and delivery of bond 6
Is a bank legally authorized to receive deposits and is not limited in meaning to one holding such deposits 6
Its bond being for an indefinite period does not affect the validity or character of the bond 10
Liability of a surety continues as long as the bank retains status 8

STATUTES CITED.

Judicial Code, Section 347, sub-section (a) 4
Title 11, Section 101, U. S. C. A. 5, 6
Title 11, Section 75, sub-section (3) U. S. C. A. 5, 6
Title 11, Section 78, sub-section (h) 7

TABLE OF CASES CITED.

Andrew v. *Bank*, 219 N. W. 34 11
Bauer v. *Highway Imp. District*, 270 S. W. 533 11
Board of Commissioners v. *Bank*, 252 Pac. 475 11
Beckley v. *Wolford*, 104 W. Va. 391 13
Continental Casualty Co. v. *U. S.*, 68 F. (2d) 577 4
Fewless v. *Keeshan*, 88 Fed. 573 9
Hoge v. *Brookover*, 28 W. Va. 210 13
Mitchell v. *Bank*, 65 S. W. (2d) 99 ..... 6, 11
Minturn v. *U. S.*, 106 U. S. 437 ..... 4, 13
Oakland County v. *Casualty Co.*, 255 N. W. 229 11
Pickens County v. *Love*, 171 S. E. 799 11
Smith v. *U. S.*, 8 L. Ed. 130 ..... 4, 13
Westervelt v. *Mohrenstechir*, 76 Fed. 118 10

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BRIEF FOR PETITIONERS.

Statement of the Case.

To this action of Debt on Bond by petitioner, in the District Court of the United States for the Northern District of West Virginia, the Kingwood National Bank, George A. Herring and respondent were defendants.

The declaration averred:

1. On July 22, 1924, said bank was, by said District Court, designated a depository for funds arising in the matter of

estates in bankruptcy and a bond required in the penalty of five thousand dollars (R. 1).

2. On July 24, 1924, the bank by James W. Flynn, its president, executed the bond in suit with said Flynn and George A. Herring as sureties (R. 2 & 3). It was approved July 30, 1924 (R. 4).

3. The bank was a depository until June 22, 1931, when it closed its doors (R. 4).

4. James W. Flynn died in March, 1931, testate and respondent qualified as executrix of his will and was acting as such at the date of suit (R. 2).

5. Petitioner, by virtue of appointment and qualification on July 24, 1930, was acting as trustee of his bankrupt estate at date of suit (R. 1).

6. By direction of the Court and its referee, petitioner, from time to time, made deposits in said depository, in his name as trustee for said bankrupt estate, of funds of the estate. When the bank closed its doors he had a balance on deposit of $3190.72 which has not been paid (R. 5).

7. Respondent filed an original and amended demurrer to the declaration, which appear at large on pages 7 and 8 of the record, but no ruling was ever made on their sufficiency.

8. A jury was waived and the cause submitted to the Court upon written stipulation of facts (R. 10).

The Stipulation.

It was stipulated that the bank was designated a depository; the bond executed and approved; petitioner was duly appointed, qualified and was still acting as trustee of the bankrupt estate; Flynn died at the time alleged and respondent was the executrix of his will; the bank closed its

doors owing petitioner, as trustee, the amount alleged, and of which amount a 10% divident, $319.07, had been paid and the remainder with its interest was still unpaid, all as alleged in the declaration.

Respondent desired to have certain other facts stipulated which petitioner believed to be immaterial and those were admitted to be true, if material and their materiality submitted to the Court:

(a) Flynn and Herring resided in Kingwood, W. Va., when the bond was given and until Flynn's death and Herring still resided there.

(b) Flynn was president, Herring vice president of the bank, and at Flynn's death Herring became the president and was such when it closed.

(c) Petitioner resided in Kingwood when Flynn died, but did not know of his death until June, 1931. He could have known of it by investigation. He did not know of Flynn's suretyship on the bond but could have known that by personal investigation.

(d) Respondent was employed in the bank for a time in each of the years 1918, 1919, 1926 and 1928, but never knew of Flynn's suretyship on the bond. (See Stipulation, R. 10 to 13, inc.)

The Judgment.

The Court entered judgment, September 21, 1935, for petitioner, against all defendants, jointly and severally, for $3680.25 with interest until paid (R. 9-10).

Respondent took a separate appeal (R. 14-15).

Jurisdiction.

Jurisdictional grounds are set out at length in the petition for certiorari in the case on pages 8 and 9.

(1) We rely upon the provisions of Section 347, subsection (a) of the Judicial Code giving authority to the Court to review by certiorari the action of circuit courts of appeals of the United States.

(2) Judgment in favor of petitioner was set aside and reversed by the United States Circuit Court of Appeals for the Fourth Circuit upon the ground that the death of Flynn automatically released his estate from liability as surety on the depository bond in question, for reasons assigned in the opinion (R. 22-26).

(3) The conclusions reached in that opinion are in substantial conflict with the judgment of the Circuit Court of Appeals for the Seventh Circuit in an analogous case, though the questions in the two cases are not identical.

Continental Casualty Co. v. *U. S.*, 68 F. (2d) 577.

(4) A Federal question of great importance was involved and decided, which question has never been passed upon by this Court.

(5) That applicable decisions of this Court in *Minturn* v. *U. S.*, 106 U. S. 437, and *Smith* v. *U. S.*, 8 L. Ed. 130, were not given proper effect by said Circuit Court of Appeals in this case.

Specification of Errors.

The Court erred:

(1) In reversing the judgment of the District Court in this case and in setting aside the judgment of petitioner.

(2) In deciding that the bond in question is analogous to a guaranty of a series of sales and not analogous to an official bond.

(3) In deciding that, by the execution and approval of said bond, the Kingwood National Bank did not become an

actual depository for funds arising from the estates in bankruptcy, but became such actual depository only if and when deposits of such funds were made therein.

(4) In deciding that the District Court must keep itself constantly advised of the solvency and continued life of sureties on such bonds.

(5) In its conclusion that if such duty exists, neglect of such duty by said court can prejudice the creditors of bankrupt estates by discharging the sureties on such bonds.

(6) In adjudging that Flynn's estate was released from liability on this bond.

Summary.

(1) The Circuit Court of Appeals assumes, contrary to reason and without justification by the record, that no funds of any bankrupt estate, except those in suit, were ever deposited in the depository.

(2) The bank became a depository, actual and not merely potential, upon execution and approval of the bond in suit, and petitioner was justified in depositing funds therein without personal investigation as to the sureties. Title 11, Section 101 and Section 75, subsection (3) of Title 11 U. S. C. A.

(3) The consideration for this bond was given all at one time. It was not the deposits that might be made in the bank in future, but the then giving to the bank a status authorizing it to receive such deposits.

(4) Even in private transactions the surety on a bond, the consideration for which is given all at one time, is not discharged by death. See cases cited on page 24 of Record.

(5) Principles and rules applicable to private transactions cannot be applied where public interest and public

policy are involved. A bond given under a statute is construed liberally to effectuate the statutory design. *Mitchell* v. *Bank*, 65 S. W. (2) 99.

Argument.

In the majority opinion it is said:

> "There is no evidence that any other bankruptcy funds were deposited in the bank before or after the death of the surety."

As such evidence would have been immaterial, irrelevant and inadmissible, of course there was no such evidence.

Whether the bank became an *actual* or merely a potential depository upon execution and approval of the bond, depends on what is meant by the term "Depository" in the statute. If it is limited to a bank having bankruptcy funds on deposit, the same bank may be a depository today, and without action by the Court, cease to be one tomorrow.

If a bank becomes a depository when authorized by law to receive deposits, then the Kingwood National Bank was a depository from date of the bond until it closed its doors.

It is said the bond was not a contract, but was a mere offer to contract until it was accepted by the making of deposits.

If an offer to contract, by whom could it be accepted?

Certainly a trustee in bankruptcy whose power was limited to depositing money received by him in a designated depository, could not so accept. "Title 11, Section 75, Subsection (3) U. S. C. A.

If acceptance was by the Court, then approval of the bond was acceptance of the offer.

Title 11, Section 101 of U. S. C. A., reads:

> "Courts of Bankruptcy shall designate, by order, banking institutions as depositories for the money of bankrupt estates, as convenient as may be to the

residences of trustees, and shall require bonds to the United States, subject to their approval, to be given by such banking institutions, and may from time to time as occasion may require, by like order increase the number of depositories or the amount of any bond or change such depositories."

Section 78, Subsection (h), reads:

"Bonds of referees, trustees and designated depositories shall be filed of record in the office of the clerk of the court and may be sued upon in the name of the United States for the use of any person injured by a breach of their condition."

The United States to whom the Court must "require bonds," has no title to or interest in the funds of any one bankrupt, but is interested in the funds of all bankrupts, for it would contravene all sound public policy for the United States through its laws and its courts in the enforcement of those laws to seize the property of bankrupts, prevent creditors from subjecting the same to their debts under state laws, and not jealously protect and preserve those funds for the creditors. No trustee can accept this bond, nor is he under obligations to go to the office of the Clerk of the Court of bankruptcy to investigate regarding the sureties thereon.

The majority opinion says (R. 24), "In our opinion the depository bond in the pending case is more nearly analogous to the guaranty of a series of sales or credits than to an official bond." We believe such bond is analogous to an official bond, and not analogous to any bond given for private purposes. Given to make the bank an officer or agent of the District Court, an arm of the government, it is in effect an official bond. Its obligee is not any trustee or a number of trustees in bankruptcy, but is the United States. Suit on such bond is in the name of the United States but for the benefit of the trustee.

Actually it is for the benefit of the creditors for whom the trustee preserves the assets.

Under state laws a constable executes a bond payable to the state. He handles no money belonging to the state, but collects money upon executions issued by the court and in other ways comes into possession of moneys belonging to various individuals. If he defaults in accounting therefor, suit is in the name of the state, but for the use of any individual injured.

A trustee in bankruptcy has no more authority to accept or reject what the circuit court has termed an offer to contract contained in the depository bond than any private individual has to accept or reject the bond of a constable or any other public official. Public policy relieves the trustee of that, and places the duty and responsibility of approval on the court.

It is not clear from the opinion just how important the Circuit Court of Appeals considers the fact to be that the respondent was ignorant of her decedent's suretyship on the bond. In the stipulation of facts her lack of knowledge was admitted, but its materiality challenged. We still deem it to be immaterial.

In the administration of estates of decedents the personal representative executes a bond, payable to the state. If a surety on such bond dies, though his personal representative may be ignorant of such suretyship, death does not terminate his suretyship, yet the hardship upon the representative is just as great upon such surety as in this case. That death does not end such suretyship is admitted in the majority opinion, and sustained by cases cited on page 24 of the record.

If a bank having been designated and having given bond as a depository does not become an actual depository until funds are deposited therein, retains its status as a depository so long as any funds are therein deposited and loses

such status when all such funds are withdrawn, then if it happened that in one bank a single trustee deposited funds, thereby accepting the suretyship of the bond, and because of litigation or other complications affecting the estate those funds would remain for many years deposited in said bank, and during that time a surety upon the bond would die, under the theory of the majority opinion in this case that bank would still be an actual depository, and the dead surety liable for all funds thereafter deposited by any trustee; while another bank, from which it might happen that all funds on deposit would be withdrawn, would cease to be a depository, and the death of a surety would terminate his suretyship and defeat the right of trustees thereafter depositing in that bank to recover on their bond.

It is held by

Fewless v. *Keesham*, 88 Fed. 573,

and other cases cited on page 24 of the record, "When the consideration for the promise is indivisible and entire and is given all at once" the death of a surety does not discharge his suretyship. We believe that in this case the consideration for the execution of this bond was given all at once; that the consideration was not that a certain trustee or trustees would in the future deposit money in the bank, but was that the bank should be authorized to receive any and all such deposits when offered.

There Is a Distinction in Reason Between Bonds Given for Public Purposes and Private Bonds.

We do not believe that the reasoning of the courts and the rules laid down as applicable to bonds for purely private purposes can be applied to such bonds as this. An examination of the cases cited on pages 24, 25 and 26 of the record will disclose that where it is held that the death of a surety with notice, and in some cases without

notice, terminated the suretyship, no public interests were involved, and in many cases the court speaks of the fact that the obligee in such bond could be by proper diligence fully protected himself. In those cases it was the obligee charged with the duty of protecting himself, and having opportunity to do so, who suffered by the release of the surety.

As we have said, in this case the obligee is the United States, but it is not the United States that suffers if the surety in such bond as this is discharged by death. The loss in such case must fall on persons who have no opportunity to protect themselves. When J. W. Flynn executed this bond to give to the bank of which he was president the status of a depository, he was bound to take notice of the responsibility which he assumed. No heir, distributee or personal representative can be charged with any loss because of his suretyship on this bond except loss of what might come to them from his estate. With full power to charge that estate as he did, and to dispose of it as he would, he executed this bond, binding upon himself, his heirs, executors, administrators, successors and assigns. So long as he lived he knew of his suretyship on this bond, and that in terms it bound his estate after his death. If then a loss is to be sustained by anyone by failure to take steps to end the liability on this bond, should that loss fall upon the estate, or upon the innocent creditors of a bankrupt estate?

The opinion stresses the fact that this bond was for an indefinite period. So was the bond in

Westervelt v. *Mohrenstechir*, 76 Fed. 118.

The Court in that case said the law relating to the subject matter of the bond must be construed as if part of the bond itself. It further held that the Court must put itself in the situation of the parties at the time they signed the

bond to determine their intention as to what would release a surety. In

Bauer v. *Highway Improvement District,* 270 S. W. 533,

it was held that the legislature had no authority to relieve the sureties on the depository bond when private individuals had a vested interest in the funds thereby secured.

A bond given in pursuance of the statute must be construed in the light of the statute, and interpreted liberally to effect the statutory design. That design in this case was to provide a place for the safe keeping and prompt paying over of funds of bankrupt assets.

Mitchell v. *Bank,* 65 S. W. (2nd) 99;
Andrew v. *Bank,* 219 N. W. 34;
Pickens County v. *Love,* 171 S. E. 799; Pt. 7;
Oakland County v. *Casualty Company,* 255 N. W. 229.

The liability of the surety on such bond continues as long as the bank retains the status given it by the bond.

Board of Commissioners v. *Bank,* 252 Pac. 475.

In the opinion (R. 28) the Court says it is the duty of the Court under Section 101, "from time to time as occasion may require, to increase the amount of any bond or change the depository." We do not so read that section. It says the Court "shall" designate depositories and take bonds, but that it "may" increase the amount of the bond or change depositories. Even if "may" were read as "shall," still no duty rests on the Court to increase amount of the bond or to change the depositories until some "occasion" therefor is called to his attention.

As is shown above, we respectfully disagree with the conclusion that the bond was only an offer to contract, and did not ripen into a contract until deposits were made; that the situation is like the continued guaranty of a series

of performances; that there was no present consideration for the bond (R. 24); that it constituted until accepted by a depositing trustee, a revocable offer (R. 25); that liability is to be determined by the question whether a reasonable time had elapsed after Flynn's death before deposits were made or that consideration can be given to what petitioner knew or could have known when the deposits were made (R. 27).

We believe that a rule vanishes when the reason for the rule is done away with, and that reason and justice demand that the liability on a bond of this character continue until a new bond is given, or the bank relieved of its status as a depository, so that funds of bankrupts will no longer be deposited therein.

We believe the statement "So far as we know, no trustee in bankruptcy had ever made a deposit in the bank under the protection of the sureties' promise" (R. 24-25), shows the Court was influenced by the statement in the demurrer to the declaration that the declaration showed no funds of said bankrupt or any other bankrupt were on deposit, and that no such deposits were made after Flynn's death for more than four years (R. 7). Such statements as to other bankrupts were wholly unfounded and unjustified. The declaration showed nothing of the kind, and it is preposterous in the absence of such showing to assume that in a community wherein so little bankruptcy existed as to make that possible the officers of a bank would seek designation of said bank as a depository and the president and vice president execute the bond in question.

We do not believe it is the duty of a district judge, with his district extending across the entire Northern part of the State of West Virginia, more than three hundred miles in breadth, and with five places in which to hold court to keep himself constantly informed of the solvency and con-

tinued life of each surety on such bond as that in suit. But assuming it was his duty, his default can not prejudice the rights of creditors of bankrupt estates.

Hoge v. *Brookover,* 28 W. Va. 210;
Smith v. *United States,* 8 L. Ed. 130;
Minturn v. *United States,* 27 L. Ed. 208;
Beckley v. *Wolford,* 104 W. Va. 391.

We respectfully contend that the opinion of Judge Parker (R. 29-31), is the better reasoned opinion, more consonant with the law and equities of this case, and we hereby adopt the same as part of this brief.

We believe that the judgment of the Circuit Court of Appeals should be reversed, and that of the District Court affirmed.

Respectfully submitted,

F. E. Parrack,
Attorney for Petitioners.

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